

RECEIVED

NOV 16 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the

FEDERAL COMMUNICATIONS COMMISSION

PROPOSED TRANSFER OF CONTROL) CC DOCKET NO. 98-141
SBC AND AMERITECH)

REPLY COMMENTS OF THE
CONSUMER FEDERATION OF AMERICA,
CONSUMERS UNION,
AND
AARP

NOVEMBER 16, 1998

No. of Copies rec'd
List ABCDE

0714

I. INTRODUCTION:
THE MERGER SHOULD BE REJECTED

In initial comments, the Consumer Federation of America¹ and Consumers Union² argued that the merger of SBC and Ameritech should be rejected by the Federal Communications Commission. Based on a review of the comments of others, CFA and CU are more convinced than ever that this is the correct public policy. In these reply comments CFA and CU are joined by the AARP.³

The Commission has been presented with a vast array of theoretical and empirical evidence from public interest groups, consumer advocates, academic economists, and market participants that the proposed merger is not in the public interest.⁴ Above all, the commentators demonstrate that the merger will be a devastating blow to the feeble forces of competition that have been struggling to become established in the market for local exchange and exchange access service.

¹ Founded in 1968, the Consumer Federation of America is the nation's largest consumer advocacy group. Composed of over 250 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, CFA's purpose is to represent consumer interests before the congress and the federal agencies and to assist its state and local members in their activities in their local jurisdictions.

² Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumer's Union's income is solely derived from Sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees.

³ AARP, celebrating 40 years of service to Americans of all ages, is the nation's leading organization for people age 50 and older. It serves their needs and interests through information and education, advocacy and community services, which are provided by a network of local chapters and experienced volunteers throughout the country.

II. THE MERGER SHOULD BE REJECTED, EVEN THOUGH OTHERS HAVE BEEN APPROVED

Commentors explain, as we did, that there is a fundamental difference between the proposed merger and those that have gone before. They argue that the market structural conditions dictate that the merger be rejected. They also point out that the Federal Communications Commission's (FCC) own observations about future mergers involving Regional Bell Operating Companies (RBOCs), which it articulated in approving prior mergers, indicate that the merger be rejected.

- The competitive harm of this much larger merger is much greater because a valuable potential competitor will be lost from the dwindling number of highly qualified potential competitors and entry will be made more difficult (Shepherd, p. 4).
- There are unique regional problems posed by the merger (Katz and Shapiro, *passim*). The greater the market power at the regional and national levels the less the likelihood that competitors will break through in the local market and the greater the likelihood that market power will be extended into related industries.
- The failure of local competition to take hold and the failure of conditions placed on previous mergers to produce open local markets indicates much stronger underlying barriers to competition than had been anticipated (Shepherd, p. 4).
- The track record of the acquiring company in retarding and opposing competition is much worse (Shepherd, p. 4, Baldwin and Goulding, para 13-26).
- The huge premium paid in this merger and the abusive and anticompetitive marketing practices implemented in California indicate that the acquiring company would have a strong incentive to preserve its monopoly and abuse its market power throughout the much larger territory it would control (Shepherd, p. 2, Consumer Coalition, p. 22).

⁴ For the purposes of these reply comments, we rely solely on the arguments, observations, and evidence presented by public interest groups, consumer advocates and academic economists. All subsequent references are to the initial comments in the instant proceeding.

- The merger sets off all the alarms that the FCC identified in approving the Bell Atlantic – NYNEX merger because, among other things, it eliminates a major LEC competitor, threatens future competition, facilitates coordination among LECs, and removes an important benchmark ((Baldwin and Goulding, paras, 24-25, 30-36).

This is a defining moment in the structure of the local telecommunications industry, with another merger lined up right behind the SBC/Ameritech proposal (Shepherd, p. 4). Now is the time to reinforce, not abandon the commitment to local competition. This merger would result in a market structure that is simply too concentrated to support effective competition.

III. THE MERGER REDUCES ACTUAL COMPETITION

Commentors identify a range of horizontal and vertical anticompetitive effects that parallel the concerns raised in our initial comments.

Actual competition will be lost in a number of markets as a result of the merger.

- Ameritech had begun to compete in St. Louis and was certified in several other SBC states (Texas, p. 8, Baldwin and Goulding, paras. 54 – 58).
- Merger talks began shortly after Ameritech started its final trial of local competition in St. Louis (Baldwin and Goulding, para. 59).
- Ameritech began to scale back its local competition efforts **after** the merger talks began (Consumer Coalition, p. 46).

Cellular competition will be eliminated (Consumer Coalition, p. 14).

- Offers to sell off local area operations of long established firms that are integrated into a national system raise questions about diminished competition, even if the overlap is eliminated.

Cable TV competition will be undermined (Consumer Coalition, p. 16).

- SBC has made it clear that it does not want to be in the traditional cable business. It took PacTel out of cable after suggesting that it would not. It has sold off its own cable systems.
- SBC would not commit to stay in cable in Connecticut and had to be ordered by the Department of Public Utilities to commit to stay in for two years. It retains the right to ask the DPU to change that commitment.
- More than 80 overbuilds are likely to be abandoned and certainly will not be pursued vigorously after SBC takes over Ameritech.

Thus the merger results in a dramatic and direct reduction of competition across several of the markets in which the Telecommunications Act of 1996 sought to increase competition. Ameritech had taken the most aggressive role among all RBOCs in entering the local exchange market and the cable TV markets. These are the least competitive of all the markets that the Act sought to open up. To allow it to merge with a sister RBOC that has one of the worst records on local competition and cable TV would be a repudiation of the goals of the Act.

IV. THE MERGER REDUCES POTENTIAL COMPETITION

Likely competition will be diminished as a result of the merger (Shepherd, p. 25; Baldwin and Goulding, paras. 60-63).

- SBC had identified Chicago as a likely market for entry in defending its takeover of PacTel. Now it claims it had changed its mind.

Potential competition will be reduced significantly as a result of the merger (Shepherd, p. 25; Baldwin and Goulding, paras. 45-63). As local telephone companies, SBC and Ameritech are the best candidates to create local competition by entering each other's service territory. With two mergers pending, the pool of major potential competitors would be reduced significantly.

- These are local carriers with the expertise, experience in local telephony, in place operating system, and the greatest knowledge of how to prevent or gain entry. They are uniquely equipped to enter each other's local markets.

SBC and Ameritech also have unique value as potential competitors in each other's service territory (Baldwin and Goulding, paras. 60-63).

- SBC is contiguous with Ameritech, which provides the best launch pad for entry through nearby facilities.
- The companies have brand name recognition through their nearby facilities and their cellular activities.

V. THE MERGER WILL MAKE IT MORE DIFFICULT TO ENTER IN-REGION MARKETS

In addition to the direct loss of actual and potential competition, which will slow down the development of a competitive market, Commentors also demonstrate that the merger will make it more difficult for other competitors to enter into the home region of the larger, post-merger company.

The sheer size of the firm created by the merger dwarfs virtually all competitors in the industry (Szerasen, *passim*, Consumer Coalition, p. 13; Baldwin and Goulding, paras. 61-62).

- No other local company would be even half as large as the "New" SBC.
- The CLECs are generally minuscule compared to the post-merger company.
- The major long distance companies, although similar in size, have few if any assets deployed to provide local service.

With the expanded service territory and dramatically increased end-to-end business, the incumbent has an even stronger incentive and greater ability to block entry.

- By controlling both ends of the transaction, there is a greater ability to engage in strategic pricing and manipulation of service quality (Katz and Shapiro, passim).⁵
- Indeed, commentators argue that both customers (Ankum, p. 5) and regulators (Farrel and Mitchell, passim) lose crucial information for evaluating incumbent behavior by allowing the merger.

The incumbent gains a vertical advantage in related markets (Texas, p. 14, Ankum, pp. 11, 26; Katz and Shapiro, passim).

- Purchasing wholesale inputs from an affiliate gives the incumbents a clear advantage
- Selling vertical services to captive basic service customers provides advantage that is unavailable to competitors.

VI. THE LOCAL MARKET STRUCTURE RESULTING FROM THE MERGER WOULD NOT SUPPORT COMPETITION

The loss of actual and potential competition is of critical importance because the local market has failed to become competitive. The negative impacts of the merger on competition are reinforced by strong concerns expressed about the problems that have been encountered in opening local markets to competition.

⁵ CFA, CU and AARP independently demonstrated the tremendous incentive to capture both ends of the long distance transaction in the Bell Atlantic-NYNEX merger, see "Direct Testimony of Dr. Mark N. Cooper on Behalf of New York Citizens Utility Board, the Consumer Federation of America, The American Association of Retired Persons, Consumers Union, and Citizen Action of New York," Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York Telephone Company, NYNEX Corporation and Bell Atlantic Corporation for a Declaratory Ruling that the Commission Lacks Jurisdiction to Investigate and Approve a Proposed Merger Between NYNEX and a Subsidiary of Bell Atlantic, or, in the Alternative, for Approval of the Merger, Petition of the New York Citizens Utility Board, the Consumer Federation of America, the American Association of Retired Persons, Consumers Union, Mr. Mark Green, Ms. Catherine Abate, the Long Island Consumer Energy Project and the International Brotherhood of Electrical Workers I-6 Council (collectively the "Consumer Coalition") for an Investigation of the Proposed Merger of NYNEX Corporation and Bell Atlantic Corporation, Case Nos. 96-C-0603 and 96-C-0599, November 25, 1996).

Commentors support the assumptions and conclusions of our initial analysis. They support our fundamental decision to use the local exchange and exchange access market as a distinct telecommunications market (Consumer Coalition, paras. 30-32). There is absolutely no doubt that this is a distinct market. As we pointed out, the distinction is deeply embedded in public policy under the Telecommunications Act of 1996, as well as economic reality. The Department of Justice analyzes this as a distinct market in its section 271.⁶ Regional markets are also a relevant level of analysis (Shepherd, p. 8).

In our initial comments we focused on the severe impact that the proposed merger would have on the concentration of ownership and control of the local exchange and exchange access market. The sad state of affairs in local competition hardly needs to be reiterated (Consumer Coalition, pp. 6-7), but Commentors do add several points.

- In addition to the fact that, the proposed merger would increase the concentration of the market by almost 500 puts, putting it well beyond the threshold of a highly concentrated market. Commentors point out that the impact on the business market would be even greater. The merged company would have a 50 percent market share of business lines, resulting in a Herschman-Herfindahl Index (HHI) well above 2500.⁷

VII. THE ACQUIRING COMPANY HAS SHOWN ITS WILLINGNESS TO ENGAGE IN ANTICOMPETITIVE AND ABUSIVE PRACTICES

A. FORECLOSING MARKETS

Commentors demonstrate with conceptual evidence (Katz and Shapiro) the importance of the empirical fact that SBC is “known as the most energetic Baby Bell in resisting competition”

⁶ See Affidavit of Marius Schwartz, Competitive Implications of Bell Operating Company Entry into Long-Distance Telecommunications Service,” May 14, 1997.

(Shepherd, p. 13).⁸ The current count on section 271 checklist items passed seems to bear this out. In California, the CPUC staff credits SBC with passing only 4 of the 14 points. In Texas, it was credited with passing only 3.⁹ In our initial comments, we identified fifty specific examples of the obstruction of local competition. The final report by the California staff and the updates out of Texas indicate that progress is slow and will remain so.

Comments filed in the FCC's proceeding on section 706 also reinforce our concern about the anticompetitive foreclosure of markets. In that proceeding CFA/CU cited a range of anticompetitive practices that have been identified by non-telecommunications companies.¹⁰

The anticompetitive practices identified included the following:

ANTICOMPETITIVE BEHAVIOR

- Denial/Delay Of Service
 - Denial Of Wholesale
 - Affiliate Preference
- Abusive Marketing
 - Steering
 - Slamming
- Information Abuse

⁷ FCC, Statistics of Common Carriers, Table 2.6 shows approximately 48 percent of all switched business access lines are located in the 13-state region that would be served by the merged company.

⁸ See also, "Testimony of Dr. Mark Cooper on Behalf of the American Association of Retired Persons," before the Illinois Commerce Commission, SBC Communications Inc., SBC Delaware, Inc., Ameritech Corporation, Illinois Bell Telephone Company d/b/a Ameritech Illinois, and Ameritech Illinois Metro, Inc., Joint Application for Approval of the Reorganization of Illinois Bell Telephone Company d/b/a Ameritech Illinois, and the Reorganization of Ameritech Illinois Metro, Inc. in Accordance with Section 7-204 of the Public Utilities Act and for all Other Appropriate Relief, ICC Docket No. 98-0555.

⁹ "Reply Comments of The Consumer Federation Of America, The International Communications Association, and the National Retail Federation In the Matter of Access Charge Reform," Price Cap Performance Review For Local Exchange Carriers Consumer Federation of America, International Communications Association and National Retail Federation Petition Requesting Amendment of the Commission's Rules Regarding Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 96-262, CC Docket No. 94-1, RM-9210.

¹⁰ In The Matter Of Deployment Of Wireline Services Offering Advanced Telecommunications Capability, Etc. CC Docket Nos. 98-147, 98-11, 98-26, 98-32, 98-78, 98-91, CCB/CPD Docket N. 98-15, RM 9244, Before the Federal Communications Commission, Washington, D. C. 20544, October 16, 1998.

Network
Customer
Bundling/Tying
Discriminatory Interconnection
Cross Connect
Degradation Of Service

ABUSE OF AFFILIATE RELATIONS

Board Of Directors Not Independent
Logo Exploited Unfairly
Asset Transfer May Be Anticompetitive
Byzantine Relations Make Oversight Impossible
Price Squeeze
Joint Marketing Abuse
Cross Subsidy/Loop Cost Shifting

Ameritech was the focal point of several comments. SBC's behavior in California was also a source of concern.

B. ABUSIVE MARKETING PRACTICES

Consumer advocates commenting on the merger have paid considerable attention to abusive marketing that has been experienced in California as a result of the merger (Consumer Coalition, pp. 19-23). From the point of view of competition analysis, the important point is that the merger economics will place immense pressure on the company to squeeze profits out of the ongoing operations of the company. SBC has paid a large merger premium and huge bonuses to Ameritech management. It has to pay for those.

As a result, consumers are likely to experience declining quality of service in transactions with the company, abusive sales practices, and an onslaught of political pressure to increase basic rates. The company will attempt to cut costs and increase sales.

One of the predictable approaches to squeezing profits out of current operations will be to centralize functions in distant locations and cut back on outlays for personal interactions between representatives of the company and the public. The second approach to paying for the merger is to increase sales of services. The hard-sell mentality that SBC has applied in its other markets will be transplanted to the Ameritech region. As a result, consumers are likely to be subject to aggressive and abusive marketing practices. Because SBC does not face competition, particularly in the residential sector, it has embarked upon a campaign of reducing the quality of transaction service with extreme speed and vigor. Within a matter of months in California there have been complaints from consumer groups, labor unions, the Office of Ratepayer Advocate, and ultimately the Commission.¹¹

VIII. THE CLAIM THAT RETALIATION BY OTHERS WILL INCREASE COMPETITION IS CONTRARY TO HISTORICAL RBOC BEHAVIOR AND SBC'S OWN REACTION TO THE ATTACK ON ITS SERVICE TERRITORY

The claim that competitors will have to retaliate in the face of SBC's national/local strategy is illogical and inconsistent with the past behavior. In the initial comments CFA/CU did not devote much attention to this claim regarding the proposed merger for a simple reason. It is clearly a ruse, intended to divert the regulator's attention from the overwhelmingly anticompetitive impact of the merger. Numerous commentators point out fundamental contradictions in the Applicant's description of the origin, purpose and justification for the national/local strategy. The plans to enter these markets must also be considered in the context

¹¹ See "Comments of AARP" in The Matter of the Joint Application of SBC Communications Inc., SBC Delaware, Inc., Ameritech Corporation, and Ameritech Ohio for Consent and Approval of a Change of Control, before the Public Utilities Commission of Ohio, Case No. 98-1082-TP-AMT.

of the recent statements about competition that the companies have made and then abandoned, as soon as regulatory approval was granted.

First, retaliatory entry has not been the historic response of incumbent local companies. SBC is the best example (Consumer Coalition, pp. 26, 30).

- SBC is the only RBOC that was under significant attack from a sister RBOC. It never retaliated. Although it identified Chicago as an attractive market, it chose to merge with the incumbent rather than compete there.
- The natural response by other incumbent LECs will be to consolidate their local monopolies, just as SBC has done.

Second, the assumptions and conditions that SBC claims make its national/local strategy necessary are illogical and inconsistent (Consumer Coalition, paras. 42-43).

- The merging companies claim that they are already beset with competition in their home service areas, but allowing them to merge will “jump start” local competition elsewhere.
- SBC claims in its section 271 proceedings that it is not the big CLECs that are carrying local competition forward, but the little guys; then it states in its merger proposal that it could not compete outside of its own service territories without becoming a huge local company that dwarfs virtually all potential competitors.

Third, the most obvious contradiction in the national/local claim about competition stems from the fact that, by its own reasoning, there would be few, if any, viable competitors in the market. In abandoning its entry strategy for Chicago, SBC now claims that brand recognition, facilities, and a customer base are not enough. It claims to need to have virtually all the telecommunications business of the large firms headquartered in its home service territory, the huge financial resources of a firm with over 40 billion in revenue and economies of scale and scope. There are no other entities that could marshal these resources (Consumer Coalition, p. 26).

- If the home court advantage is as important as the merging partners claim, then allowing one company to lock up half the business lines in the country would create a huge obstacle to any second, national local competitor.
- For the 50 percent of the nation's business lines that SBC would now command, there is virtually no competitor outside of the region that possesses any of the traits the merging firms claim are necessary for successful competition.

Given the underlying assumptions of the national/local argument, SBC-Ameritech would completely dominate the national/local market.

Commentors reject the claims that the scale and scope of the merger is necessary to achieve economic efficiency (Consumer Coalition, para. 39).

- Economies of scale can be achieved without the national/local strategy. Others have entered the large business market, which is the primary target of the strategy without a national/local claim.
- The merging companies intended to rely on multiple switches in the new markets and purchase of unbundled loops. Therefore, entry does not require the scale claimed.

A more plausible alternative economic explanation of the national/local strategy rests on market power, not economic efficiency. Moreover, to the extent that the national/local strategy would produce out-of-region competition, it would do so in the market segments that have the most competition to date (Consumer Coalition, p. 28).

- In the local market the SBC strategy first targets large business in the largest urban centers that have the most competition.
- In the long distance market, which is substantially more competitive than the local market, the LECs that have gained entry have not offered vigorous price competition.

The only example available of planned entry by an RBOC into a partially competitive telecommunications market is SBC's tariff proposal for long distance in Oklahoma. The

Department of Justice demonstrated that the price offer represented little in the way of competitive gain. The Texas Office of Public Utility Counsel also showed that SBC was proposing decidedly inferior rates.

Similarly, CFA has demonstrated that SNET and GTE have not brought good price offers to the long distance market. Instead, they leverage their monopoly power and brand names to sell inferior products.¹² With respect to SBC's claims about long distance gains, CFA presented the following analysis in California.¹³

The fundamental weakness in the company analysis can be summarized in the following table.

COMPANY	RATE PLAN	AVERAGE PRICE
AT&T	AVERAGE BASIC (11/97)	18.1
AT&T	OVERALL AVERAGE PAID 1996	16.2
AT&T	ONE RATE	15.0
SWBT	PROPOSED RATE	14.0
AT&T	TRUE REACH	13.6
SPRINT	SPRINT SENSE WITH DISCOUNT	13.1
MCI	MCI ONE SAVINGS	12.2
WEB SITE	VARIOUS OFFERS	9.0

The company has estimated savings to consumers based on a comparison between an estimated 1996 average price of 16.2 cents per minute and its proposed \$.14 rate. It has simply ignored all of the other options out there and assumed that customers would switch to SWBT to save money, even though they could save more by switching to someone else. SWBT's claim for hundreds of millions of dollars in consumer savings has no basis in the reality of the current long distance market.

¹² Stonewalling Local Competition, January 1998.

¹³ "Affidavit of Dr. Mark N. Cooper on behalf of the Consumer Federation of America," Rulemaking on the Commission on to Govern Open Access to Bottleneck Services and Establish Framework for Network Architecture Development of Dominant Carrier Networks. Investigation on the Commission's Own Motion Into Open Access and Network Architecture Development of Dominant Carrier Networks. Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service Order Instituting Investigation on the Commission's Own Motion Into Competition for Local Exchange Service. Before the Public Service Commission of California, R.93-04-003, I.93-04-002 R.95-04-043R.95-04-044

The market the RBOC proposed to enter already has better products available.

IX. CONCLUSION

Based upon the clear evidence that the merger would be anticompetitive in markets that are sorely in need of increased competition and of little benefit in other markets, there is little likely gain to the public and great likely harm from this merger. The Commission should reject the merger.

Respectfully submitted,

**CONSUMER FEDERATION
OF AMERICA**

**Mark Cooper
Director of Research**

CONSUMERS UNION

**Gene Kimmelman
Washington, Co-director**

AARP

**Martin Corry
Director of Federal Affairs**

November 16, 1998